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Credit Trends:

Taking Stock Of The Oil And Gas Sector After The Recent Downgrades

Global Fixed Income Research:

Diane Vazza, Managing Director, New York (1) 212-438-2760; diane.vazza@standardandpoors.com

Nick W Kraemer, FRM, Senior Director, New York (1) 212-438-1698;

nick.kraemer@standardandpoors.com

Evan M Gunter, Associate Director, New York (1) 212-438-6412; evan.gunter@standardandpoors.com

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Taking Stock Of The Oil And Gas Sector After The Recent Downgrades

Standard & Poor's Ratings Services took several rating actions on companies in the oil and gas sector as volatile oil prices rocked the sector. Standard & Poor's revised its crude oil price assumptions down to \$55 per barrel of Brent (and \$50 per barrel of West Texas Intermediate) crude oil on January 9, and a number of negative rating actions followed: 16 oil and gas companies globally were downgraded in January, the highest number of monthly downgrades for the sector since April 1999. The negative bias for the sector jumped by 4% in the month to 24%; however, crude prices showed intermittent gains in recent weeks, and credit spreads for the sector have tightened since December. While the drop in oil prices poses challenges to the sector overall, those companies with the weakest credit strength are most likely to bear the brunt of continued volatility.

Overview

- Halfway through the first of quarter 2015 (as of February 17), 26 oil and gas companies have been downgraded: The largest number of oil and gas downgrades over a single quarter since 1999, when 28 were downgraded.
- Two-thirds of the companies in the oil and gas sector (250) globally are rated speculative-grade ('BB+' and lower); 7% of corporate speculative-grade ratings are in this sector.
- Oil and gas companies globally have \$150.9 billion of speculative-grade debt scheduled to mature through 2019, or 8% of total nonfinancial speculative-grade debt maturing over this period.

The Oil And Gas Sector Has 9% Of U.S. Speculative-Grade Ratings

Two-thirds of the oil and gas sector globally is rated speculative-grade ('BB+' and lower), or 250 companies (see chart 1 and table 1). The majority of speculative-grade oil and gas companies are based in the U.S. (168; the region includes Bermuda and the Cayman Islands), followed by Canada (34).

Of global oil and gas companies, 58 are rated 'B-' or lower, and 15 are among the global weakest links. Weakest links are issuers rated 'B-' and lower with either negative rating outlooks or ratings on CreditWatch with negative implications. These issuers on the lower end of the speculative-grade spectrum are poised to be downgraded and have greater default risk than higher-rated entities.

Globally, the oil and gas sector is 5% of corporate ratings (including investment- and speculative-grade), but the share rises when we look at subsets of ratings by grade and by region. The oil and gas sector is 9% of U.S. speculative-grade ratings, and 19% of the speculative-grade ratings in the other developed region (oil and gas companies from the other developed region primarily are Canadian, although this region includes Australia, New Zealand, and Japan).

Chart 1

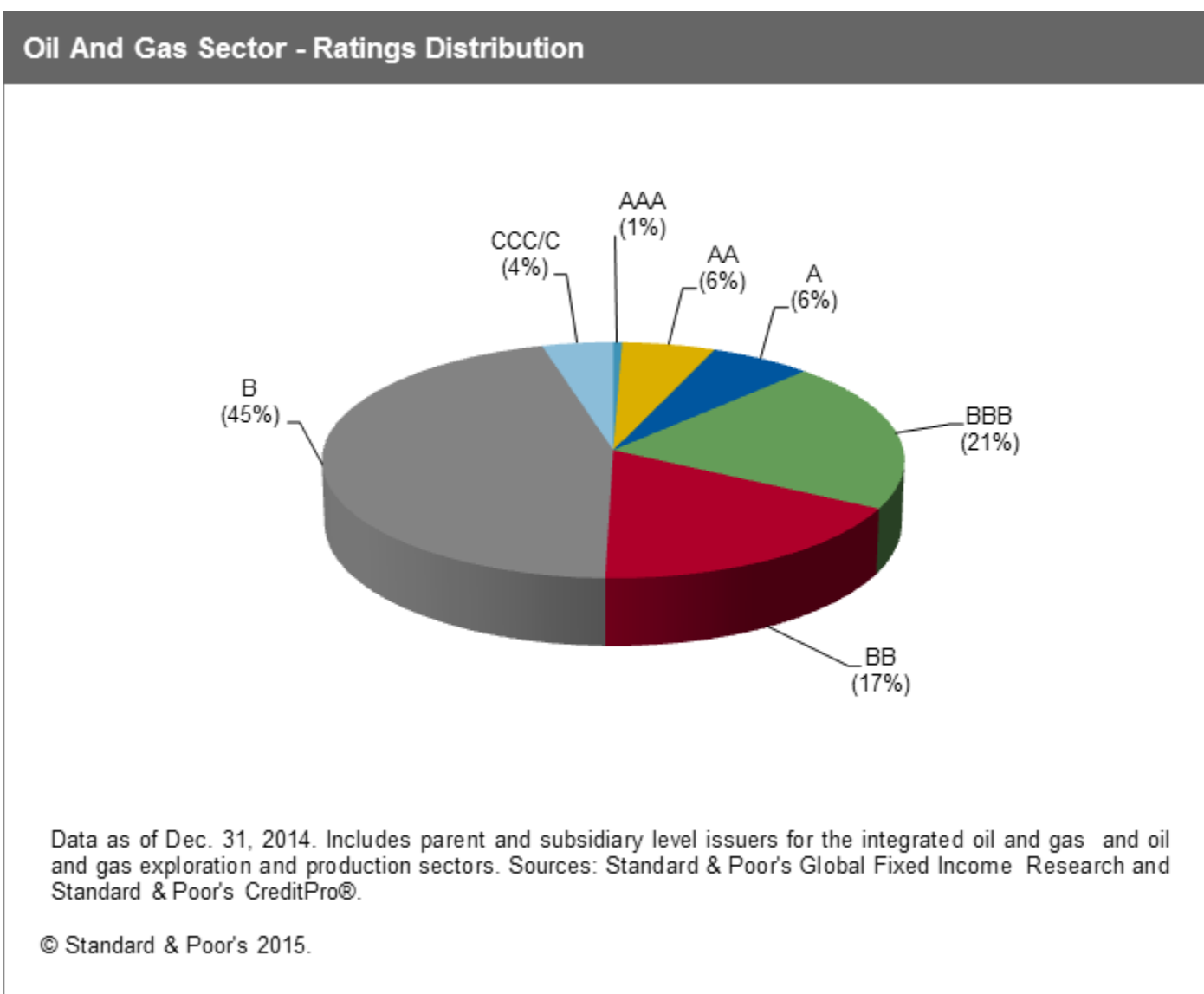


Table 1

Oil And Gas Sector - Ratings Distribution					
	U.S.	Europe	Other developed	Emerging markets	Global
Investment grade (count)	53	20	13	37	123
Percentage of region's investment-grade ratings	4%	2%	3%	5%	4%
Speculative grade (count)	163	28	34	25	250
Percentage of region's speculative-grade ratings	9%	4%	19%	3%	7%
Total (count)	216	48	47	62	373
Percentage of region's total ratings	7%	3%	7%	4%	5%

Note: Table shows the number of rated companies by region. Data as of Dec. 31, 2014. Includes parent and subsidiary level issuers for the integrated oil and gas and oil and gas exploration and production sectors. Sources: Standard & Poor's Global Fixed Income Research and Standard & Poor's CreditPro®.

Downgrades For The Sector Rose In Recent Months

Oil and gas companies were hurt by the sharp drop in crude prices since mid-year 2014. Revenue projections are falling with prices, and the number of downgrades in the sector rose in recent quarters (see chart 2). In the fourth quarter of 2014, 21 oil and gas companies were downgraded globally; 11 were upgraded. In the first quarter of 2015 (through February 17), 26 oil and gas companies were downgraded, and just two upgraded. The last time that we saw this many oil and gas companies downgraded in a single quarter was in the second quarter of 1999, when 28 companies were downgraded following a plunge in oil prices and a pullback in the industry.

Looking at the number of rating actions by region, we see that, while the majority of recent downgrades were in the U.S., these downgrades have been somewhat mitigated by a number of 2014 upgrades in the sector (see chart 3). Upgrades for U.S. oil and gas companies reached a 2014-high in the fourth quarter; for all of 2014, the downgrade ratio (the share of rating actions that were downgrades) was just 43% for oil and gas companies in the U.S., as upgrades outnumbered downgrades. Outside the U.S., the downgrade ratio for oil and gas companies was 73% in 2014.

Chart 2

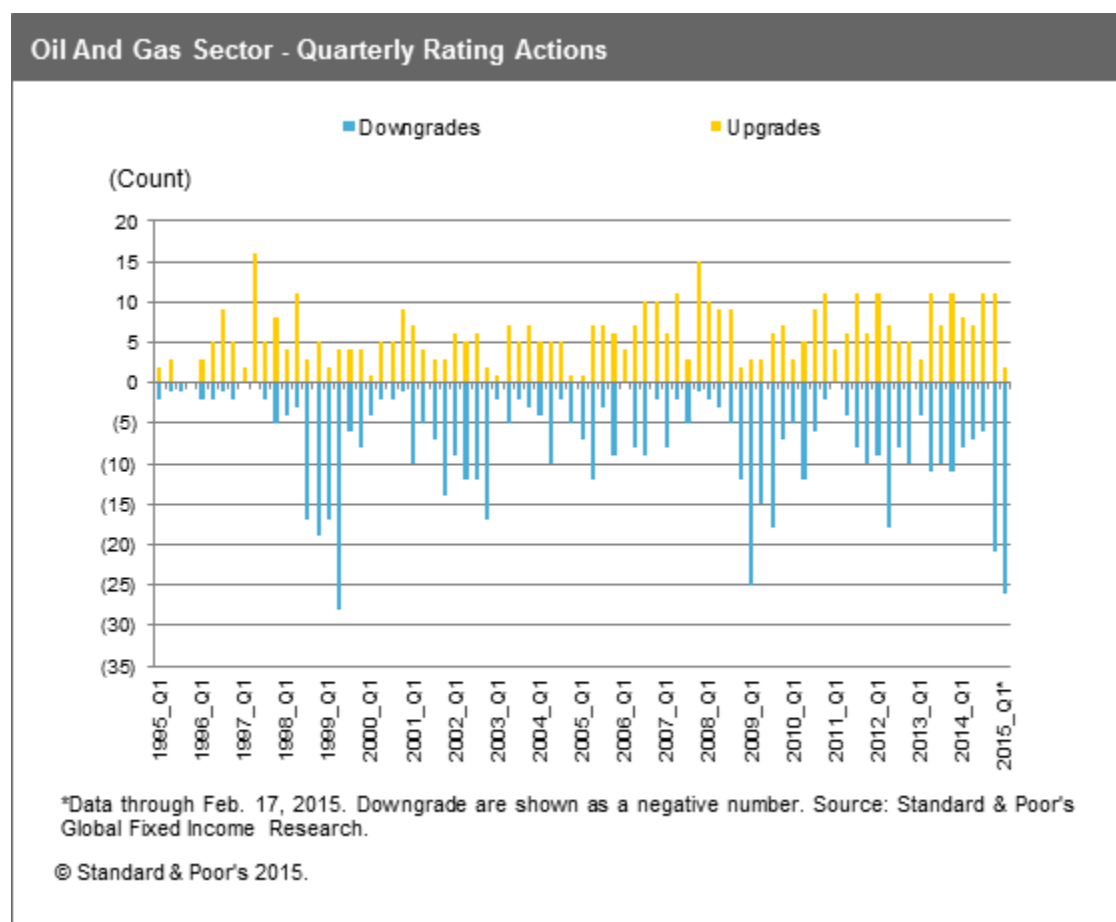
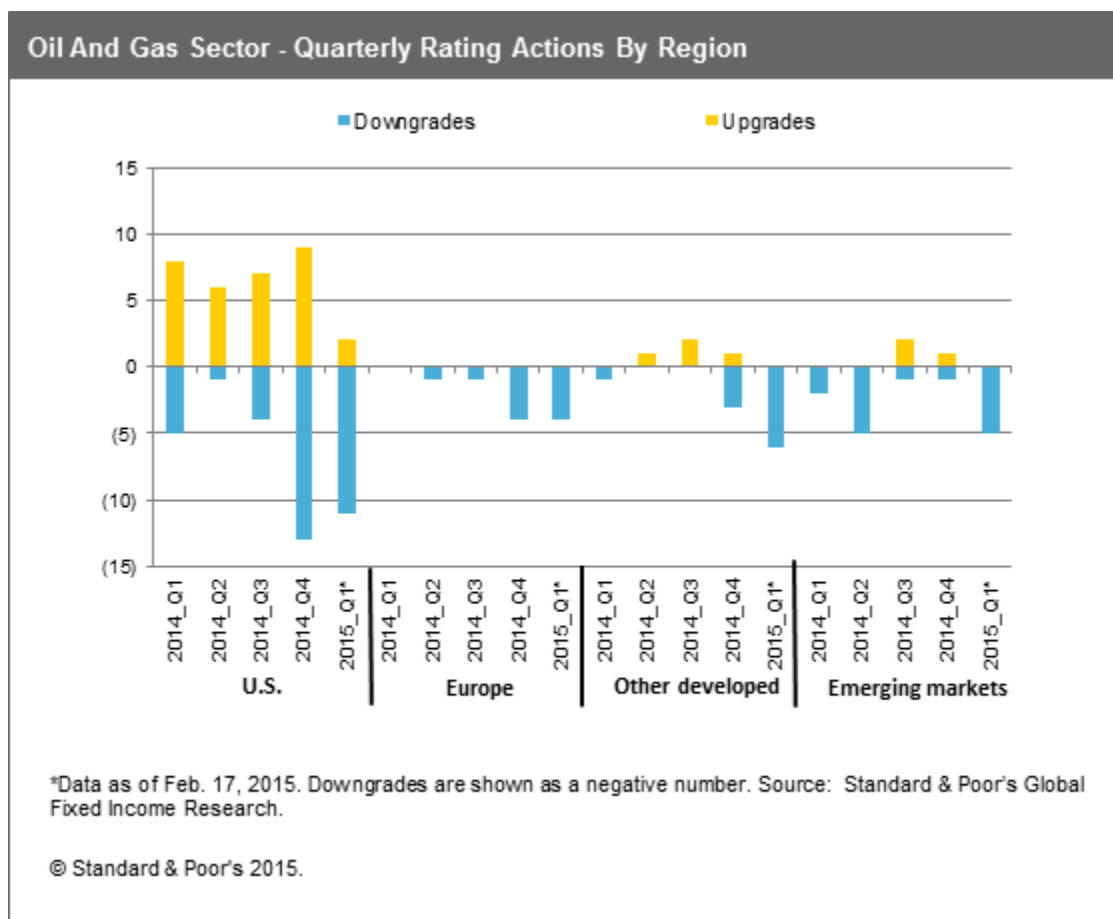


Chart 3



The outlook for future rating actions in the sector has quickly grown more negative: The negative bias (i.e., the share of companies with negative outlooks or with ratings that are on CreditWatch with negative implications) climbed rapidly, to 21% for U.S. companies as of Jan. 31, 2014, from 11% at the end of the third quarter (see chart 4). Over the same period, the negative bias climbed to 29% from 23% for non-U.S. oil and gas companies, the highest since 2009. The negative bias for U.S. oil and gas companies rose 8% over the past three months, marking the steepest increase in the sector's negative bias over a three-month period since it rose 22% in the first quarter of 2009.

Despite the rising downgrades, and the sector's increasingly negative bias, the 12-month trailing default rate for oil and gas companies declined in recent months, to 1.0% and 1.3% for U.S. and non-U.S. companies, respectively, as of Dec. 31, 2014 (see chart 5). In 2014, there were five defaults by oil and gas companies, a decrease from seven in 2013. The 2014 defaults included two U.S. companies (Endeavour International Corp. and Global Geophysical Services Inc.), two Canadian companies (Tuscany International Drilling Inc. and Southern Pacific Resources Corp.), and one from Azerbaijan (Baghlan Group FZCO). If we look at just the U.S. speculative-grade companies from the sector, the 12-month trailing default rate is 1.4% at the end of December, slightly lower than the overall trailing-12-month speculative-grade default rate of 1.6% at that time. In 2015 thus far, there have been two defaults in the oil and gas sector: Canada's Connacher Oil And Gas Ltd. and the U.K.'s Afren PLC.

Chart 4

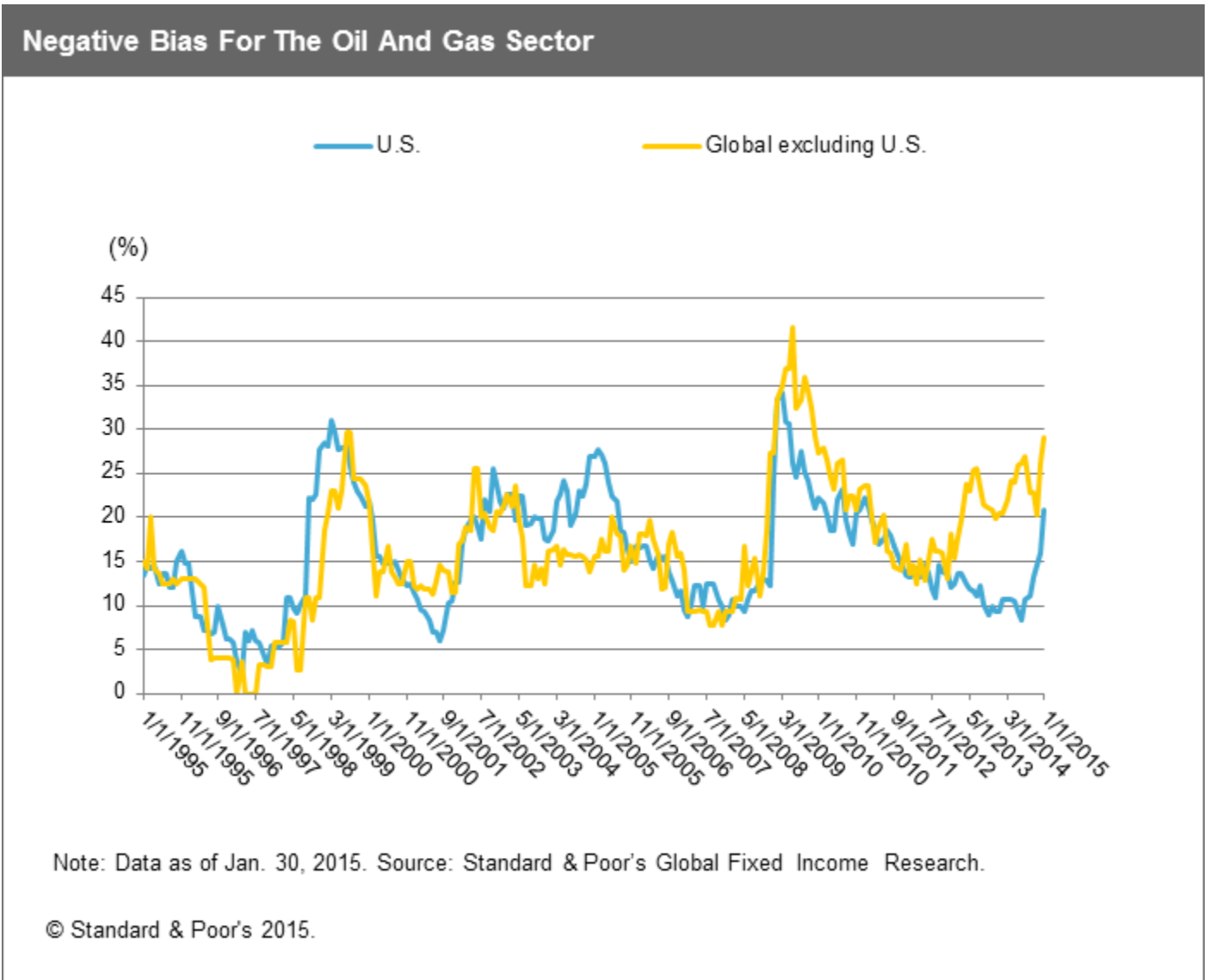
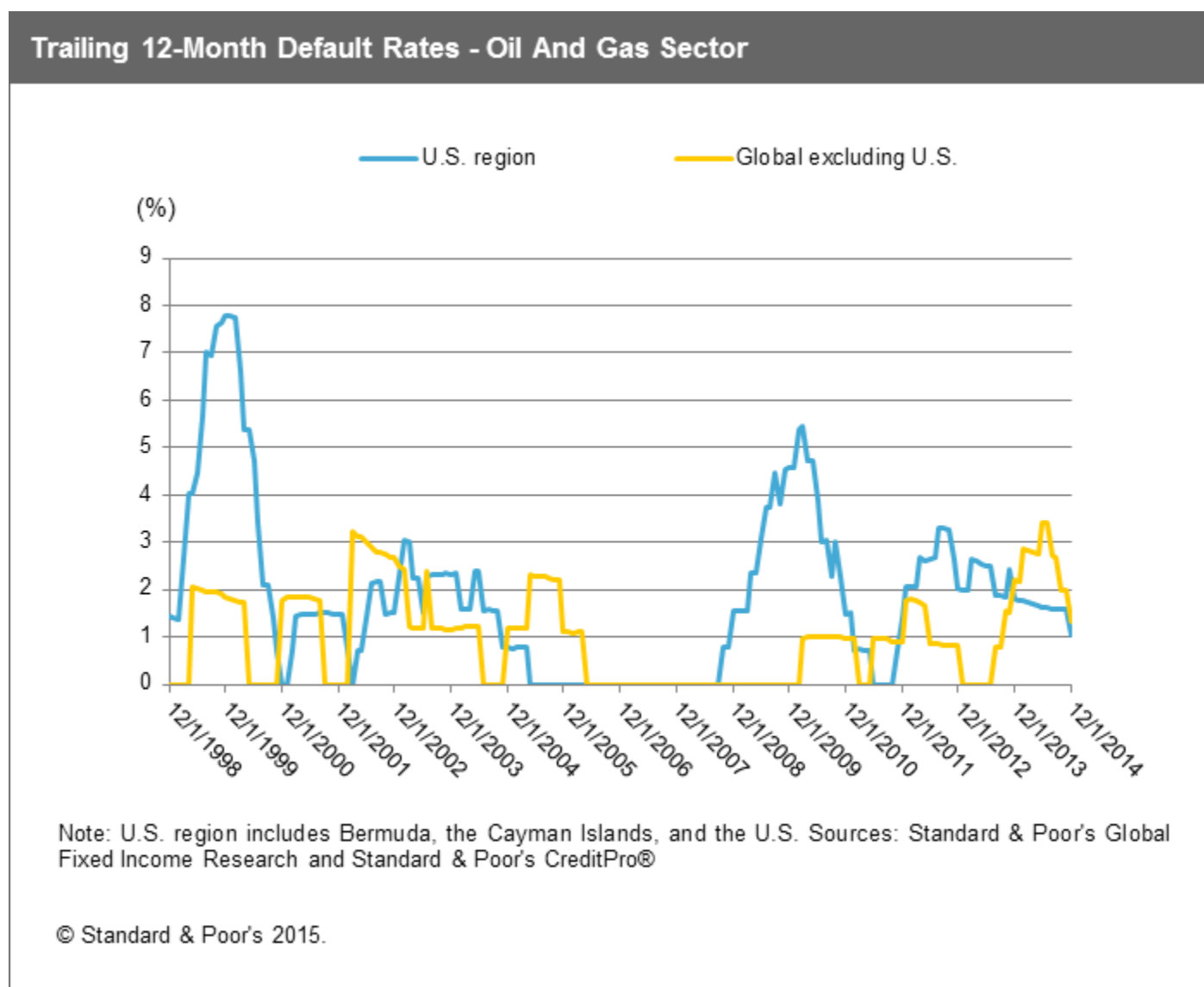


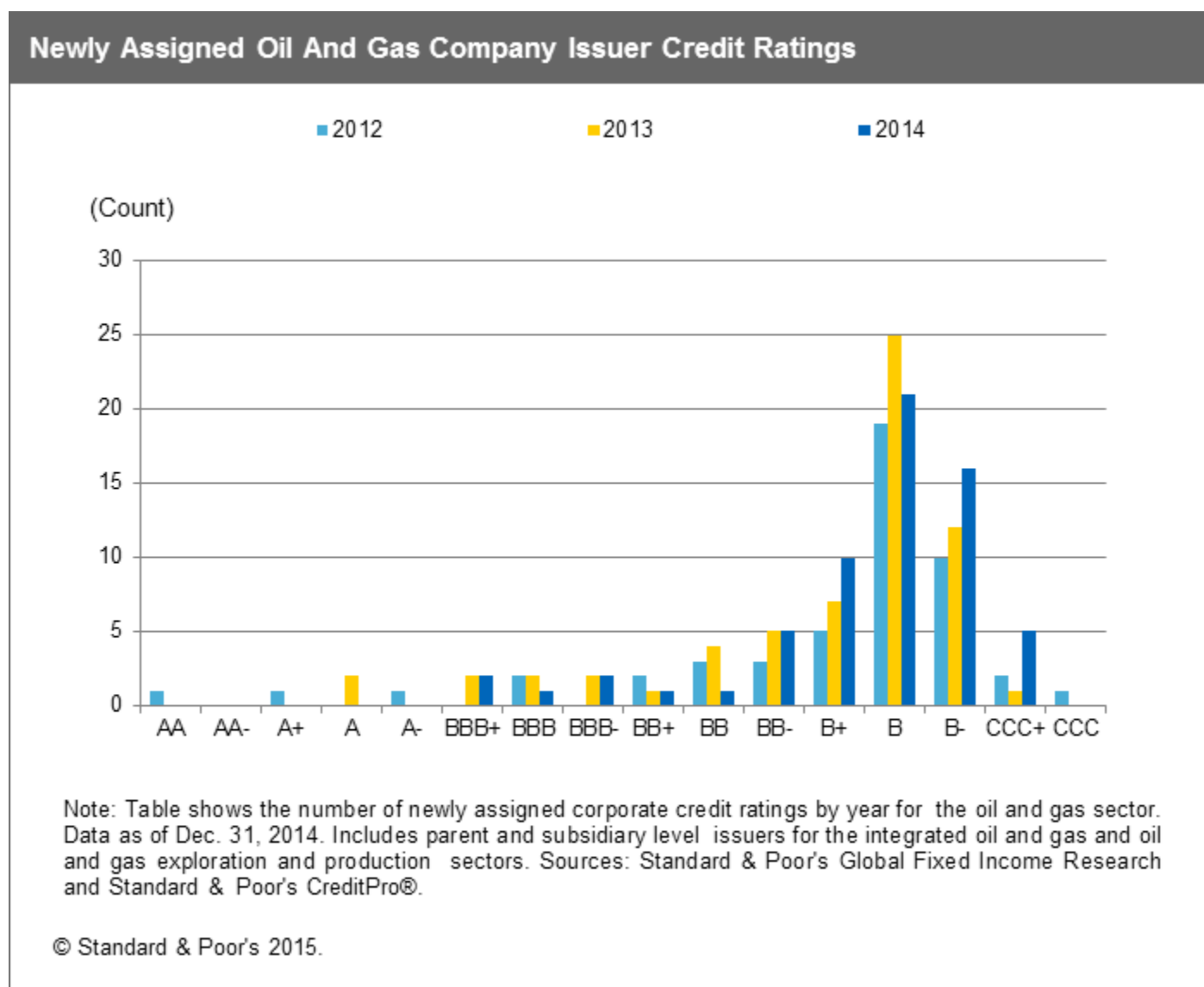
Chart 5



The number of new oil and gas company ratings assigned by Standard & Poor's rose to 64 in 2014, from 63 in 2013, and 50 in 2012 (see chart 6). Overall, 74% of all new ratings assigned across all sectors in 2014 were rated speculative-grade, and 55% were in the 'B' category. The oil and gas sector had a higher share of lower-rated entities among the new ratings assigned in 2014; 92% of those new oil and gas issuer ratings assigned in 2014 were speculative grade, and 73% were in the 'B' category.

Oil and gas companies were 7% of all new corporate credit ratings assigned in 2014. New ratings in this sector trailed the media and entertainment and the banks and brokerages sectors, which each had more new ratings assigned, with 86 and 81, respectively. Of the newly assigned oil and gas ratings, most were for companies based in the U.S (35), followed by Canada (12).

Chart 6



More Than \$160 Billion In Speculative-Grade Oil And Gas Debt Due To Mature Through 2019

While new bond issuance by oil and gas companies declined from the highs of recent years, it still remains higher than 2010 and 2011. Investment-grade issuance of \$101 billion in 2014 lagged the 2013 volume by 7%, while speculative-grade issuance of \$46 billion lagged 2013 by 9% (see charts 7 and 8).

The oil and gas sector's corporate composite credit spread climbed rapidly in 2014, especially for speculative-grade companies as crude prices fell. From June 20 to December 16, the five-year oil and gas speculative-grade composite spread climbed by more than 900 basis points (bps), to the year's high of 1290 bps, while five-year speculative-grade corporate spreads overall widened by a more moderate 214 bps to 605 bps. Since reaching that high, oil and gas

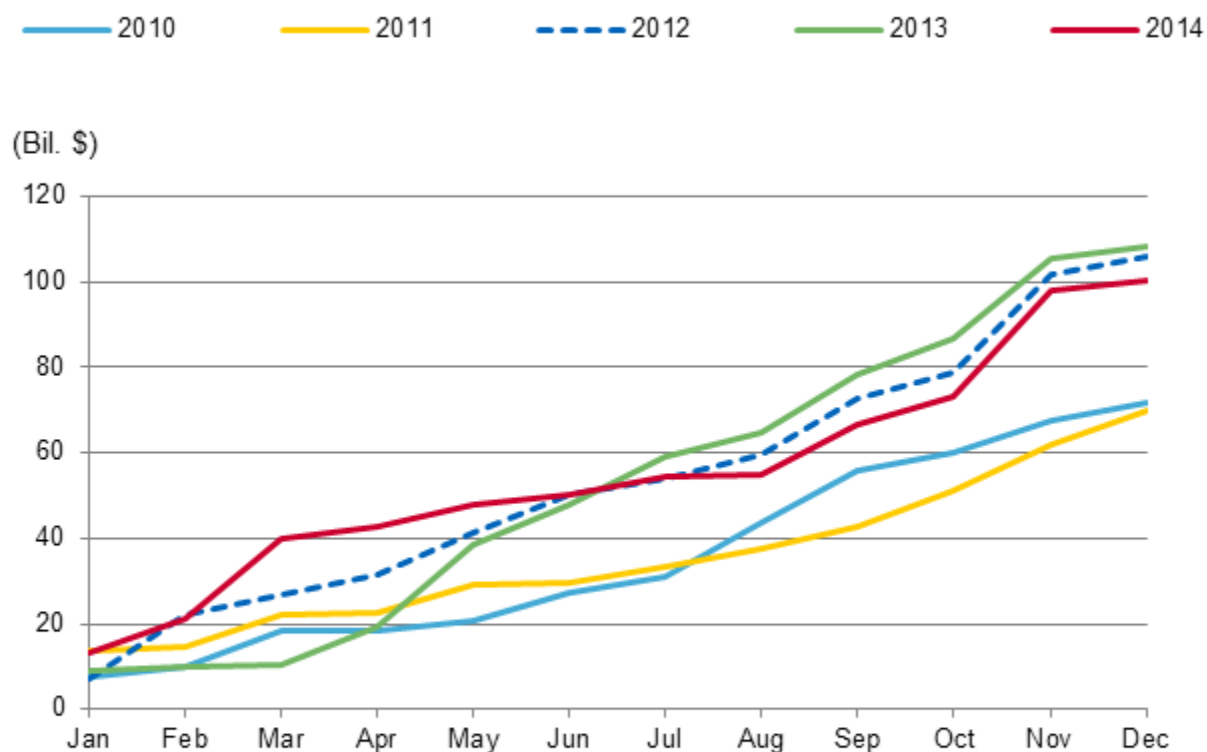
spreads have contracted to 956 bps as of Feb. 12, 2015, and the overall speculative-grade spread has contracted to 556 bps (see chart 9).

As oil and gas spreads widened, we saw an increase in the number of distressed credits from this sector. Distressed credits are speculative-grade issues with option-adjusted composite spreads of more than 1,000 bps relative to U.S. Treasuries, and these issues are the weakest of the speculative-grade population. As of January 15, there were 58 distressed issuers in the U.S. oil and gas sector, but as spreads have since moderated, the number of oil and gas distressed issuers has fallen to 46 (as of February 17).

Investment- and speculative-grade bond total returns have diverged on a total return basis since oil prices started falling in 2014. From July 2014 through January 2015, investment-grade oil and gas bonds saw a net gain of 1%, while speculative-grade oil and gas bonds have fallen by near 18%; in comparison, speculative-grade bonds overall fell by 3% during the same period. Oil and gas bond trends reversed in February, as speculative-grade bonds rebounded by 3.5% (through February 12), while investment-grade ones declined by almost 1% (see chart 10).

Chart 7

Global Oil And Gas Investment-Grade Bond Issuance (Cumulative)

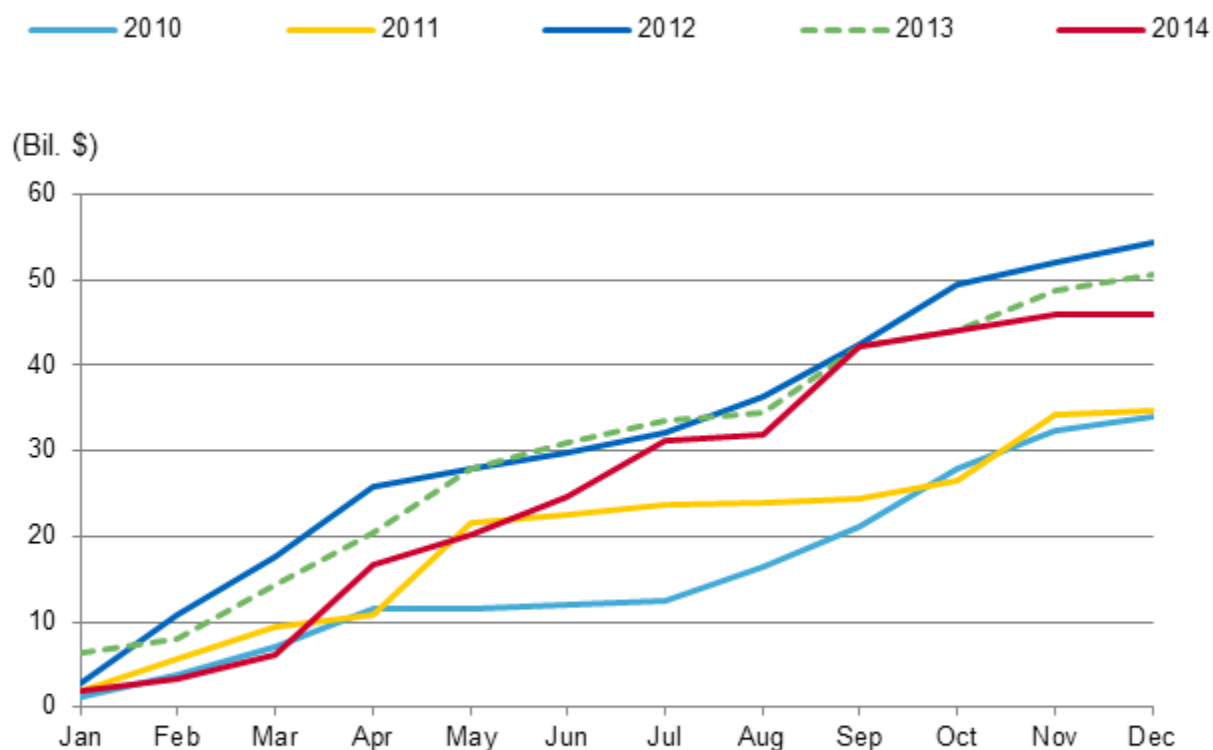


Sources: Standard & Poor's Global Fixed Income Research and Thomson Financial.

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Chart 8

Global Oil And Gas Speculative-Grade Bond Issuance (Cumulative)

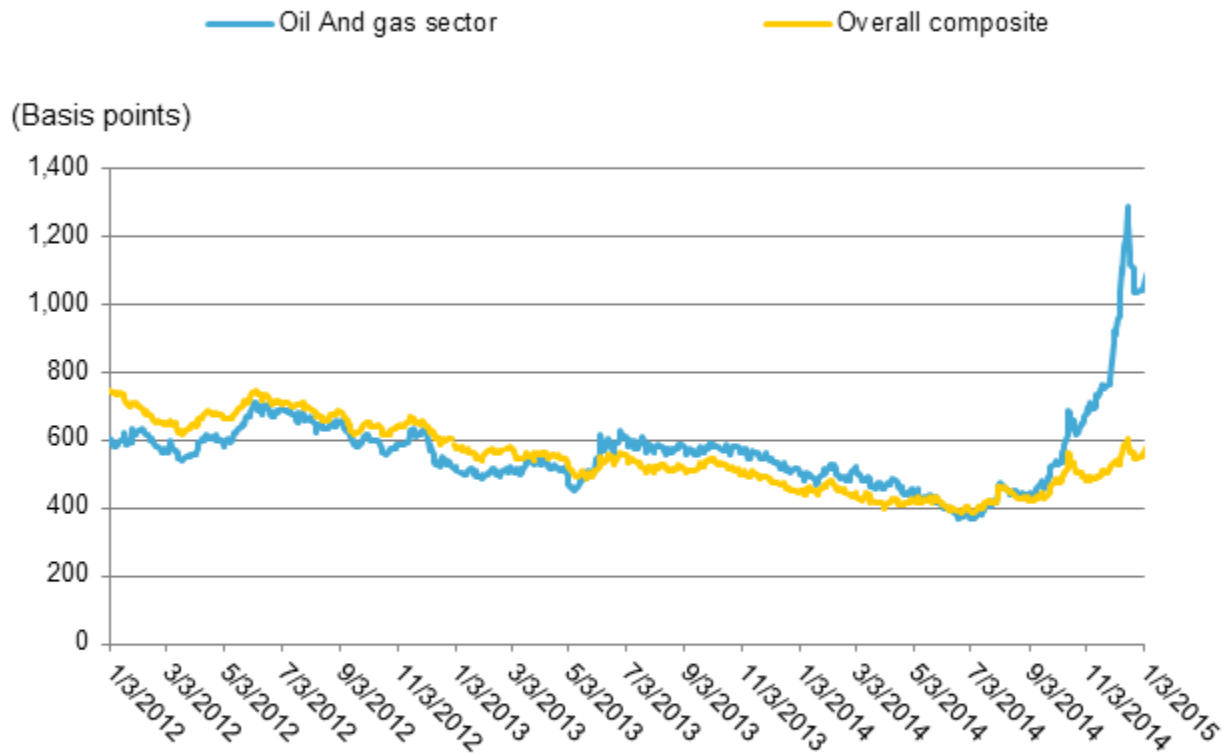


Sources: Standard & Poor's Global Fixed Income Research and Thomson Financial.

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Chart 9

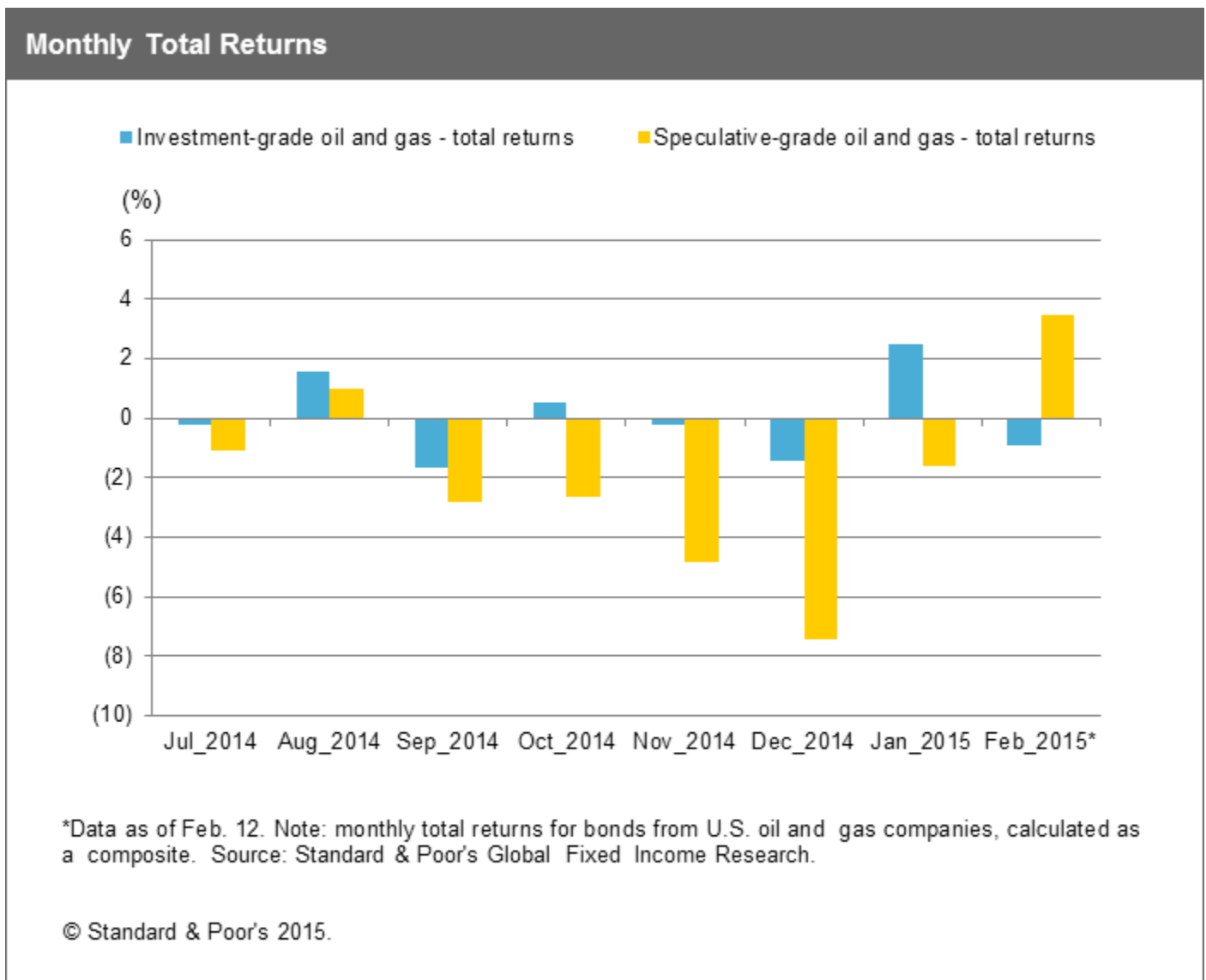
Daily Composite Spreads For Speculative-Grade Five-Year Bonds



Note: Credit spreads for U.S. corporate speculative-grade bonds with a five-year maturity, calculated as a composite. Data as of Feb. 12, 2015. Source: Standard & Poor's Global Fixed Income Research.

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Chart 10



In total, we estimate that \$620.5 billion in oil and gas sector debt rated by Standard & Poor's Ratings Services will mature through the end of 2019, 13% of the total amount of nonfinancial debt maturing over the period, and higher than any of the other nonfinancial sectors. The sector with the next-highest amount of debt maturing is telecommunications, with \$549 billion (see table 2). Much of the maturing debt for the oil and gas sector is from investment-grade companies, including several large integrated producers; if we look at just the speculative-grade debt maturing through 2019, the amount is considerably lower.

Oil and gas companies globally have \$150.9 billion of speculative-grade debt scheduled to mature through 2019, 8% of total nonfinancial speculative-grade debt maturing through 2019. The majority of the oil and gas speculative-grade debt is from U.S. companies (57%), followed by European companies (26%).

Only a small share of the speculative-grade debt is scheduled to come due this year or next. In the U.S., \$4.2 billion is

set to mature in 2015, and \$9.2 billion in 2016; in Europe, \$3.5 billion is set to mature in 2015, rising to \$6.4 billion in 2016. Speculative-grade oil and gas maturities are scheduled to escalate over the next four years, reaching a peak of \$61 billion in 2019.

Table 2

Oil and Gas Sector Maturing Debt (Bil. \$)						
	2015	2016	2017	2018	2019	Total
Investment grade						
U.S.	11.4	13.3	23.7	18.2	43.4	110.1
Europe	46.1	49.5	42.3	45.5	49.2	232.5
Other developed	1.0	0.9	4.3	5.2	2.7	14.0
Emerging markets	17.7	21.7	23.4	21.9	28.4	113.1
Total investment grade	76.1	85.4	93.6	90.8	123.8	469.7
Speculative grade						
U.S.	4.2	9.2	14.3	20.7	37.6	86.0
Europe	3.5	6.4	6.5	8.4	14.5	39.5
Other developed	0.3	0.6	0.8	3.2	4.6	9.6
Emerging markets	1.1	0.7	9.2	0.6	4.2	15.8
Total speculative grade	9.2	16.9	30.8	33.0	60.9	150.9
Totals						
U.S.	15.7	22.5	38.0	38.9	81.0	196.1
Europe	49.6	55.9	48.8	53.9	63.7	272.0
Other developed	1.3	1.5	5.1	8.4	7.3	23.6
Emerging markets	18.9	22.4	32.5	22.5	32.6	128.9
Total oil and gas maturing debt	85.4	102.3	124.4	123.7	184.7	620.5

Data as of Dec. 31, 2014. Note: Includes Integrated and exploration and production sectors. Includes bonds, loans, and revolving credit facilities. Estimates are likely biased on the high side, because our tallies do not always take into account amortization schedules and loan paydowns. Additionally, revolving credit facilities are usually tallied at full value whether or not they are fully drawn. Foreign currencies are converted to U.S. dollars at the exchange rate on the close of business on Dec. 31, 2014. Source: Standard & Poor's Global Fixed Income Research.

Related Research

- Default, Transition, and Recovery: Global Weakest Links And Default Rates: Default Risk Becoming More Pronounced Among Ukrainian Corporate Issuers, Feb. 9, 2015
- Credit Trends: Distressed Debt Monitor: The U.S. Distress Ratio Remains Elevated, At 13.4%, Jan. 30, 2015
- Standard & Poor's Revises Its Crude Oil And Natural Gas Price Assumptions, Jan. 9, 2015
- Credit Trends: Falling Oil Prices Are Starting To Hurt Corporate Issuers And Their Bonds, But Defaults Are Still Muted, Dec. 8, 2014

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